ST 02-0001-PLR 01/14/2002 COMPUTER SOFTWARE

Transactions for the licensing of computer software that meet all of the criteria provided in 86 Ill. Adm. Code 130.1935(a)(1) will not be subject to Retailers' Occupation Tax liability. See 86 Ill. Adm. Code 130.1935. (This is a PLR.)

January 14, 2002

Dear Xxxxx:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (see the enclosed copy of 2 Ill. Adm. Code 1200.110), is in response to your letter of December 4, 2001. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of the Section 1200.110 appears to be contained in your letter request. This Private Letter Ruling will bind the Department only with respect to COMPANY for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither COMPANY nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

In your letter, you have stated and made inquiry as follows:

This is a private letter ruling request by Company made pursuant to 2 Illinois Administrative. Code 1200.11.

Factual Background

The Company, headquartered in STATE, is beginning to branch out into other states. We license software to customers and also provide additional services for separate fees. A copy of the Company's standard Software License and Services Agreement (the 'Agreement') is attached.

The Company is not under audit by the Illinois Department and has no litigation pending with it. This request is intended to provide guidance as to the taxability of its software by Illinois. The Company has not previously requested a private letter ruling from the Illinois Department on this Issue.

Legal Authorities

The Company respectfully believes that the software it licenses using the enclosed Agreement is exempt from collection of sales/use tax under Illinois statute, 86 Ill. Adm. Code Sec. 130.1935.

That section of the code provides that the software is not taxable if:

A. It is evidenced by a written agreement signed by the licensor (Company) and the customer.

Both the customer and the Company sign a form of the Agreement prior to any shipment or payment of the software.

B. The agreement restricts the customer's duplication and use of the software.

- Under clauses 2.1 and 2.2 of the Agreement, the customer must use the software only for its own internal data processing operations and may copy the software for archival purposes or backup purposes only and may only use it in accordance with the agreement for processing the licensed Persons on Plan (POPs).

C. The agreement prohibits the customer from licensing, sublicensing or transferring the software to a third party.

- Under clause 2.2 (d), the customer may not use the software for commercial time-sharing, rental or service bureau use, distribute or sub-license the software, or otherwise make the software available to any third party. Additionally, it cannot decompile, disassemble, reverse engineer, prepare a derivative or compilation work of the software or develop a competing product.

D. The vendor (Company) will provide another copy at minimal or no charge if the customer loses or damages the software.

- We believe that our allowance to the customer to make an archival, backup copy comports with this provision. Also while not stated in the agreement, in the event that the customer fails to make the archival copy or loses all copies the Company will provide a replacement copy at minimal or no charge. This is not per se in the agreement but is the Company's standard policy. The Company has in the past shipped replacement copies of the software at no charge to its customers who either lost or have damaged their copy of the software.

- Additionally under clause 8 on the warranty, as part of the Company's good faith attempt to correct any substantial non-conformity to the software specifications (meaning it does not function as intended), the Company would provide another working replacement copy.

E. The customer must destroy or return all copies of the software to the vendor (Company) at the end of the lease period.

- Under clause 11.1, the agreement and license are perpetual unless terminated in which case the customer must cease using the software and certify to the Company that it has destroyed or returned to the Company the software and all copies. Customers who have terminated their Agreement in the past have either returned the software to Company or have certified in writing that they have ceased all use of the software and have destroyed all copies in their possession.

If your conclusion as to the taxability of the software differs from ours on interpreting the statute and other rulings made by the department, we appreciate the opportunity to discuss the issues with you further.

Please use Company instead of our name and keep confidential our agreement. Thank you.

This ruling is based on the facts provided in your letter of December 4, 2001 and the COMPANY'S Software License and Service Agreement (Agreement) enclosed with the letter.

Transactions for the licensing of computer software that meet all the criteria provided in the enclosed copy of 86 Ill. Adm. Code Section 130.1935(a)(1) will not be subject to Retailers' Occupation Tax liability. As set forth in the Department's rules, "a license of software is not a taxable retail sale if:

A) it is evidenced by a written agreement signed by the licensor and the customer;

B) it restricts the customer's duplication and use of the software;

C) it prohibits the customer from licensing, sublicensing or transferring software to a third party (except to a related party) without the permission and continued control of the licensor;

D) the licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or of permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records or supported by a notarized statement made under penalties of perjury by the licensor; and

E) the customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement."

After review of the COMPANY'S Agreement, we find that it meets all the criteria for a license of software set forth in Section 130.1935(a)(1). The Agreement is a written agreement that is signed by both the COMPANY as licensor and the customer. Sections 2.1 and 2.2 of the Agreement restrict the customer's duplication and use of the software. Subsection (d) of Section 2.2 prohibits the customer from using the software for commercial time-sharing, rental or service bureau use, or from distributing, sublicensing or otherwise making available the software to any third party. Facts provided in the letter request state that COMPANY has an unwritten policy of providing replacement copies at minimal or no charge in the event the customer fails to make an archival copy or loses the software. It is not stated in the letter request whether the unwritten policy is evidenced by past records of replacement copy shipments to customers at no additional charge. However, the COMPANY has a policy set forth in Section 2.1 of the Agreement allowing the customer to make and keep archival and backup copies of the software, which meets the requirements of Section 130.1935(a)(1)(D). Section 11.1 of the Agreement provides that the license is a perpetual license and also requires that in the event of termination of the Agreement, the customer must destroy or return the software and all copies of the software. As COMPANY'S license of software meets all the criteria set forth in Section 130.1935(a)(1), it qualifies as a license of software not subject to sales tax.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336. You may also find the Department's Web site useful, which can be accessed at www.revenue.state.il.us.

Sincerely,

Dana Deen Kinion
Associate Counsel

DDK:msk
Enc.